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State of Vermont
Public Service Board

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May 20, 1998

Ms. Magalie Roman Salas
Office of the Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: State Forward-Looking Cost Studies for
Federal Universal Service Support
CC Dockets No. 96-45 and 97-160

Dear Ms. Salas:

In August of 1997, the Vermont Public Service Board indicated that it would file a cost study to apply to the distribution of federal high cost support to Vermont. Under a recent FCC order, that study is now due on May 26, 1998. The Vermont Public Service Board appreciates the cooperative spirit in which the FCC has sought these state studies.

Nevertheless, Vermont hereby withdraws its intention to file a cost study. We have reached this decision because too many significant questions of federal and state policy toward high cost areas remain undecided.

The key problem is that the FCC itself does not have a cost study against which to compare a proposed Vermont filing. If Vermont did file a cost study, and if it were approved by the FCC, it would supplant the FCC's own cost study. But since that FCC cost study is not yet defined, Vermont today has no basis to know whether its own filing would more accurately reflect costs than would the FCC's own study.

A second important dimension in our decision is that filing a study could impose significant constraints on our future actions with regard to universal service. A fundamental requirement of the FCC's order is that states that submit cost studies must distribute any state funds that may be raised under section 254(f) of the Act in accord with that study. Therefore, any decision that today we might build into a cost study would constrain our subsequent decisions under section 254(f).

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It is possible, of course, that Vermont may not ultimately need a supplemental program under section 254(f). The FCC has recently indicated that it is willing to consider other options than the "25-75" split of support between jurisdictions. This could reduce the probability that a supplemental state program will be needed. However, not even the outlines of such a new system are yet apparent. Whatever the FCC's final decision, it seems likely that its financial contribution to high cost areas will be limited. Therefore, we continue to assume that there is at least a substantial possibility that, following the FCC's final decision, a supplemental state program will be needed. Accordingly, filing a cost study now might limit the state's options in designing a supplemental state program under section 254(f).

One particularly significant federal requirement for state cost studies is that they must de-average costs to the wire center level or smaller ("wire center requirement"). Since the filed study must be used in the state's own program, we understand this to mean that any state filing a cost study must be prepared to distribute its own supplemental support on a wire center basis, or smaller.

We are unable to make that commitment at this time. The first reason is our continuing uncertainty about whether the proxy models predict the pricing behavior of a competitive market. The second reason is that we are uncertain how a small-area high cost program will interact with other economic elements in the local exchange market.

A fundamental reason for high cost support, and hence a cost study, is that Congress and the FCC have judged that with the advent of local exchange competition, the pricing of telecommunications products will move closer to underlying cost. In particular, the FCC's wire center requirement appears to assume that this force will come to bear primarily in a geographic context, and that competitors will make calculations over small geographic areas.

Likewise, the cost models under consideration at the FCC calculate average support levels for many small geographic areas. Once a benchmark has been set and total costs are known for a small area, support is calculated for each customer in that region. Translated into high cost support, it is usually assumed that a customer anywhere in that region will generate equal support. The model therefore assumes that all customers within the region will be offered uniform prices.

In a competitive and unregulated market, it seems possible that telecommunications carriers might choose quite different ways to establish prices. For example, carriers today often differentiate between high volume and low volume customers, and they tend to give the lowest prices to high volume customers, regardless of location. This volume discounting seems quite likely to continue in a competitive market, regardless of location.

Even if a carrier were to establish pricing geographically, the geographic scale could be smaller or larger than those used by the cost models. At one extreme, a rational carrier trying to be competitive by matching prices to cost might utilize customer-specific prices. Since loop cost is a strong driver of overall cost, the carrier might, for example, charge remote customers more than customers with short loops. Such a pricing system could be established without regard to wire center or census block group. Conversely, a carrier in a competitive market might choose to set prices over a much larger scale. For example, a competitive carrier might set prices over a large mass media marketing region, thereby increasing its ability to reach customers with a simple and understandable pricing message.

There is one additional reason why we are reluctant to conclude that a Vermont program must inevitably operate over small geographic areas. We are not yet certain how such a system would interact with other rules and factors affecting the local exchange market.

The Commission has recognized that opportunities for arbitrage could exist if different methodologies were used for unbundled network elements and for high cost support. We agree that this could be a problem. Indeed, it is difficult to envision a coherent regulatory system in which unbundled network elements and high cost support are calculated at different scales.[1] Yet we do not understand how the FCC anticipates this problem will be solved. Therefore, we are not ready at this time to make a commitment to de-average unbundled network elements to the wire center level or lower.

We understand and appreciate that the FCC initially offered this opportunity to file a cost study from a desire to work cooperatively with state commissions. We appreciate the FCC's thoughtfulness in this regard, and we look forward to a continued close working relationship with the Commission. Nevertheless, for the reasons stated above, the Vermont Public Service Board will not file a cost study on or before May 26, 1998. In the future, should the FCC again offer a similar opportunity under different circumstances, we might accept the offer.

Sincerely,

Richard H Cowart

Richard H. Cowart
Chairman

1. The issue is presently in litigation here (Docket 5713) as to how many zones should exist for the pricing of unbundled network elements. One alternative is to have three pricing zones. If this choice is made, it could be inconsistent with the more than 100 zones in Vermont that would be required by the FCC's wire-center requirement.